

Pension Advances: Legitimate Loans or Shady Schemes?

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Before the
United States Senate
Special Committee on Aging

September 30, 2015

Chairman Collins, Ranking Member McCaskill, and distinguished Members of the Committee, thank you for the opportunity to speak to you today regarding the secondary sales of pension income streams. I am a staff attorney for the Arkansas Securities Department (“Department”) and am here on the Department’s behalf to discuss our investigation and findings of one such company that created a platform to facilitate transactions between buyers and sellers of income streams derived from assets that have fixed payment amounts and terms, such as retirement or military pensions.

Background

The Department is charged with implementing and overseeing the Arkansas Securities Act (“Act”). Pursuant to the Act, the Department regulates the sale of securities, securities brokerage firms and their agents, and state-registered investment advisers and their representatives. Our duties include implementing registration, enforcing compliance, investigating consumer complaints, and promoting investor education.

The Staff of the Department (“Staff”) initiated an investigation on Voyager Financial Group, LLC on January 26, 2012.¹ On April 23, 2013, the Arkansas Securities Commissioner (“Arkansas Commissioner”) issued a Cease and Desist Order against VFG, LLC f/k/a Voyager Financial Group, LLC (“VFG”) for the sale of unregistered securities. Order No. S-12-0015-13-OR02, *In the Matter of VFG, LLC f/k/a Voyager Financial Group, LLC, Andrew Gamber, Kevin McNay, Robert Henry, and Jonathan Sheets*. On March 18, 2014, the Arkansas Commissioner entered a Second Cease and Desist Order for untrue statements of a material fact or omission of a material fact in connection with the sale of a security. Order No. S-12-0015-14-OR06, *In the Matter of VFG, LLC f/k/a Voyager Financial Group, LLC, and Richard Younkman*. In lieu of a hearing on the two cease and desist orders, a consent order was entered into on June 23, 2014, where the parties agreed that secondary sales of income streams are considered investment contracts and therefore securities that were not properly registered or exempt pursuant to the Act. VFG and Gamber agreed to stop selling securities through the use of misstatements and omissions of material information in violation of the Act. Order No. S-12-0015-14-OR07, *In the Matter of VFG, LLC f/k/a Voyager Financial Group, LLC, and Andrew Gamber*.

Although Staff believes that Gamber ceased doing business as VFG, there is suspicion that Gamber continues to operate a similar enterprise under another company name. The Department currently has an ongoing investigation against Strategic Marketing Innovators, LLC, BAIC, Inc., and Andrew Paul Gamber.

¹ Staff originally inquired into the business of the company after receiving a call from an Arizona resident inquiring about VFG.

Facts

VFG is a Delaware limited liability company that at all times referenced herein had its principal place of business in Arkansas. VFG has never been registered with the Department in any capacity. Andrew Gamber (“Gamber”) was the managing member of VFG, owning 100% of the company as of February 20, 2013. Gamber is a resident of Arkansas and has not been registered with the Department in any capacity.² At all times referenced herein, Gamber held at least a 32% interest in VFG. Gamber has been the managing member since February 28, 2012. Richard Younkman (“Younkman”) is a resident of Dallas, Texas. Younkman has not been registered with the Department in any capacity. In addition, Younkman has not been registered on CRD³ with any state securities administrator since 2009.

VFG created a platform that facilitated transactions between buyers and sellers of income streams derived from assets that have fixed payment amounts and terms, such as retirement or military pension streams (“platform”). VFG determined the present value of the income streams and sold the streams to interested buyers through the platform. VFG recruited a network of individual agents to find potential buyers and sellers and to help facilitate the sales of pension income streams. Younkman was an agent of VFG.

An individual who wanted to sell his or her income stream appointed VFG as an

² Gamber was licensed with the Arkansas Insurance Department as a resident life and accident and health insurance producer. He entered into a consent order with the Arkansas Insurance Commissioner in 2008, placing him on probation for two years for intentionally misrepresenting the terms of an insurance policy. In 2009, Gamber entered into a consent order with the Arkansas Insurance Commissioner to revoke his license for additional violations. The 2008 and 2009 consent orders are attached hereto as Exhibits A and B, respectively.

³ CRD is the Central Registration Depository operated by the Financial Industry Regulatory Authority (“FINRA”). FINRA is a self-regulatory organization in the securities industry.

authorized “buying agent” to submit a contingent offer to a third-party buyer. VFG provided the potential buyer with a “closing book” comprised of all the information gathered from the seller regarding the income stream. As represented by VFG, the information contained therein was “all of the information that the [b]uyer need[ed] to make an informed decision on whether to follow through with the purchase.” The buyer and seller did not directly communicate during this process. All information and contracts were provided by VFG. All paperwork bore the VFG logo. Furthermore, counsel for VFG encouraged an agent to complete most of the paperwork, so buyers only were required to sign the paperwork. VFG provided the buyer with a purchase application, and VFG accepted the offer to purchase on behalf of the seller.

Once an income stream was purchased, the buyer would forward the purchase-price amount to VFG which set up an escrow account with an escrow company to hold that amount and make certain distributions and payments. The buyer did not acquire title or ownership of the underlying asset that provided the income stream but acquired a contractual right to receive the income stream from the annuity or pension. Once the seller assigned the right to receive the income stream to the buyer, the seller created an escrow account in his or her name and control. The seller granted the escrow company a special, durable power of attorney enabling the escrow company to manage that account and the income-stream funds received. VFG worked with the buyer to instruct the escrow company to direct payments of a monthly amount to the buyer for the term agreed upon at the time of sale. Because the buyer did not acquire title or ownership of the underlying asset that provided the income stream, a seller could redirect the stream back to the seller at any time, leaving the buyer with only a legal claim.

The buyer had the option for VFG to facilitate payments of premiums for a life insurance policy on the seller of the income stream because the income streams are life contingent. Further, the buyer had the option to purchase a two-year contestability wrapper through VFG from an insurance company. VFG then coordinated the purchase of the life insurance policies and collateral assignments of pre-existing life insurance policies.

VFG drafted all of the required paperwork and facilitated the execution of the contracts and agreements by involved parties. Additionally, VFG received a percentage commission from all sales at closing. VFG offered and sold income streams to investors through agents, like Younkman. VFG authored and provided agents with all the documents necessary to offer and sell these income streams to investors.

From on or about February 8, 2011 to August 20, 2012, VFG facilitated approximately 317 sales in 31 states for an estimated total of \$34,245,351.48 and received an estimated \$6,724,049.71 in commissions. VFG paid additional commissions to an estimated eighty-one agents between February 2011 and July 2012. Multiple sales were made to two Arkansas residents during that time.

On or about April 20, 2012, and May 18, 2012, VFG and Younkman offered and sold income streams to a married couple residing in Horatio, Arkansas, Arkansas Residents 1 ("AR1").⁴ AR1 invested approximately \$63,000 in April and approximately \$87,000 in May with VFG and Younkman. In eight separate transactions ranging from on or about June 6, 2011, to August 2, 2012, VFG offered and sold income streams to

⁴ AR1 are senior citizens who informed Staff that the only income they had was the income stream payments and social security. AR1 were told by their agent that these investments were government insured. AR1 were not aware of the redirect risks.

an Arkansas resident, Arkansas Resident 2 (“AR2”). AR2 invested approximately \$297,000 during that time.

As part of the offer and sale of the income streams to AR1, VFG and Younkman provided a Closing Book to AR1. The Closing Book included a document prepared by VFG and titled Purchase Application. On page one of the Purchase Application it stated as follows:

A purchase of Payments is only suitable for persons who have adequate financial means and who will not need immediate liquidity from this asset. There is no public market for this asset, and we cannot assure that one will develop, which means that it may be difficult for you to sell your asset.

This statement omitted and failed to provide AR1 with full and complete disclosure of material facts, including, but not limited to, that the assignment of federal pensions or pension payments are prohibited by federal law, and the full extent of the illiquid nature of VFG’s investments. Although VFG’s statement used some disclosure language that is similar to that found in many private placement securities offering documents, no suitability information was ever gathered from AR1 by VFG or Younkman. Since VFG included this language on its Purchase Application, VFG clearly understood that their investments were not suitable for every investor. In spite of this fact, VFG and Younkman never asked AR1 for information typically obtained in order to make a suitability determination, such as their yearly income, liquid net worth, age, and investment experience.

On page two of the VFG Purchase Application, it discussed individual life insurance policy coverage on the seller of the income stream. In addition, on the same page of the Purchase Application it discussed wrap insurance policy protection provided

by Lloyd's of London for the first two years of AR1's investments. However, VFG omitted and failed to provide AR1 with full and complete disclosure of material facts, including, but not limited to, details on the insurance coverage or the payment of premiums for this insurance. Also, VFG did not disclose the risks that the seller's life insurance policy might not actually be purchased, the premium payments might not be sent, the seller's insurance policy might lapse, or the seller's insurance policy might not be honored for some other reason. Further, VFG provided AR1 no details or proof that VFG ever had a wrap insurance policy with Lloyd's of London on the sellers of the income streams purchased by AR1. Finally, VFG omitted and failed to disclose the fact that a life insurance policy provides no protection against the seller unilaterally stopping or redirecting the income stream payments away from AR1.

The Closing Book also included a document prepared by VFG and titled Contract for Sale of Payments. On page two, paragraph number five of the Contract for Sale of Payments it stated, "For the consideration described in the Sales Assistance Agreement, Seller shall transfer and sell to Buyer at Closing one hundred percent (100%) of Seller's right, title, and interest in and to the Payments." This was clearly a misstatement in view of federal laws prohibiting the assignment or transfer of federal pensions. Also, this section of VFG's Contract for Sale of Payments failed to adequately disclose to AR1 the risk that the sellers of income streams could at any time redirect the payments away from AR1. If the sellers redirected these income stream payments, then AR1's only recourse would be a civil suit against the sellers.

On page three of the Contract for Sale of Payments it also stated, in all capital letters, "BOTH PARTIES INTEND THAT THE TRANSACTION(S) CONTEMPLATED

BY THIS CONTRACT FOR SALE SHALL CONSTITUTE VALID SALE(S) OF PAYMENTS AND SHALL NOT CONSTITUTE IMPERMISSIBLE ASSIGNMENT(S), TRANSFER(S), OR ALIENATION OF BENEFITS BY SELLERS AS CONTEMPLATED BY APPLICABLE LAWS; HOWEVER, CERTAIN RISKS EXIST.” While this document prepared by VFG mentioned risks, VFG omitted and failed to provide AR1 with full and complete disclosure of any specific risks. In addition, this section misstated federal laws and court cases that clearly prohibit the assignment or transfer of federal pension payments sold by VFG and Younkman to AR1. Therefore, in spite of the language of this section of VFG’s Contract for Sale of Payments, the sellers and not AR1 would maintain all rights and claims to these pension payments. On page three of the Contract for Sale of Payments it stated, again in all capital letters, “BY EXECUTING THIS CONTRACT FOR SALE, BUYER AND SELLER ACKNOWLEDGE THAT BUYER AND SELLER ARE AWARE OF AND EXPRESSLY ACCEPT ALL RISKS ASSOCIATED WITH THE TRANSACTION(S) CONTEMPLATED HEREIN.” While this section of the document prepared by VFG mentioned risks, VFG omitted and failed to provide AR1 with full and complete disclosure of any specific risks.

VFG has never registered or filed a proof of exemption in accordance with the Act and has never notice filed in accordance with federal law in connection with a covered security for offers and sales of securities in Arkansas.⁵

⁵ Ark. Code Ann. § 23-42-501 provides that it is unlawful for any person to offer or sell any security in this state which is not registered or which is not exempt from registration under the terms of the Act unless it is a covered security under the Securities Act of 1933. Certain covered securities require an issuer to file a notice of the transaction with the Department prior to or within 15 days of a sale in Arkansas.

Securities Analysis Under Arkansas Law⁶

Ark. Code Ann. § 23-42-102(17)(A) defines “securities” for the purposes of the Act and includes in that definition the term “investment contracts.” The Act was promulgated to protect investors, and it utilizes a broad definition of securities to determine which transactions are subject to the Act. *Carder v. Burrow*, 940 S.W.2d 429, 431 (Ark. 1997) (citing *Schultz v. Rector-Phillips-Morse, Inc.*, 552 S.W.2d 4, 8 (Ark. 1977)). In *Schultz*, the Court held that the definition of a security under the Act should not be given a narrow construction but that “it is better to determine in each instance from a review of all the facts, whether an investment scheme or plan constitutes an investment contract... within the scope of the statute.” 552 S.W.2d at 10.

When faced with the question of whether an investment is an investment contract and therefore a security, courts in Arkansas apply the five-prong risk capital test set out in *Smith v. State*, 587 S.W.2d 50 (Ark. Ct. App. 1979). The five elements of the risk capital test are “(1) the investment of money or money's worth; (2) investment in a venture; (3) the expectation of some benefit to the investor as a result of the investment; (4) contribution towards the risk capital of the venture; and (5) the absence of direct control over the investment or policy decisions concerning the venture.” *Id.* at 52. Furthermore, the United States Supreme Court has defined an investment contract as a “contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party....” *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946).

In *Grand Prairie Sav. and Loan Ass'n, Stuttgart v. Worthen Bank and Trust Co.*,

⁶ For a more detailed discussion of the investment contract analysis see Order No. S-12-0015-13-OR02, *In the Matter of VFG, LLC f/k/a Voyager Financial Group, LLC, Andrew Gamber, Kevin McNay, Robert Henry, and Jonathan Sheets*, Conclusions of Law.

N.A., 769 S.W.2d 20, 22 (Ark. 1989), the Arkansas Supreme Court noted that the *Smith* test is substantially the same test used in the federal courts and cited *Union Nat'l Bank v. Farmers Bank*, 786 F.2d 881 (8th Cir. 1986), involving two Arkansas banks and applying the *Howey* test in its analysis. However, as highlighted in *Schultz*, the Court rejected an express adoption of this federal test in favor of a more flexible case-by-case analysis, 552 S.W.2d at 10.

As required by the *Smith* risk capital test, the buyers contributed to the risk capital of the venture by paying money to receive the income-stream payments that were reassigned from the original owner and seller to the buyer for a period of time. The purchase price was then redistributed to the agents and VFG to pay commissions, with the remaining balance going to the seller. The full amount of the purchase price was not forwarded directly to the seller. Money was first paid in the form of commissions to VFG and its agents before a lesser amount was forwarded to the seller. The buyer was then at risk of the income streams being improperly redirected to the seller.

Additionally, the final requirement of the *Smith* risk capital test was satisfied, as there was an absence of direct control over the investment as well as an absence of control over policy decisions concerning the venture. VFG connected the buyers and sellers who would not otherwise transact business, if not for VFG's coordination and involvement in the venture. Although a contract dictated that the income stream was assigned to the buyer, the buyer had no actual control over the income stream. If the income stream was redirected and the buyer was no longer receiving the income, VFG stepped in, contacted the seller to determine the problem, and tried to remedy the

problem for the buyer. VFG reached out to the seller and relayed information back to the buyer. One buyer stated that there was never direct involvement with the seller throughout the income-stream transaction.

VFG and its agents facilitated all contact and transactions. In addition, all paperwork between the buyer and seller was on VFG letterhead and was reviewed by VFG. VFG vetted the seller and verified that the information provided by the seller was correct. VFG verified that there was actually a pension income stream and received a credit report from the seller to ensure there were no liens on the income stream. Additionally, VFG determined the value of the income stream. Examining the totality of VFG's responsibilities and efforts, the return generated to the buyer depended on VFG's managerial skills in conducting pre-closing investigations and analyses, verifying all information was in place, verifying that there was a life insurance policy either purchased or collaterally assigned in case of the death of the seller, and providing all necessary paperwork to the buyers and sellers to facilitate the transaction.

Given that the Arkansas Supreme Court has not expressly adopted *Howey* in favor of a more flexible case-by-case approach in order to avoid a narrow construction of the Act, the transactions described herein were investment contracts pursuant to the risk capital test. As Ark. Code Ann. § 23-42-102(17)(A)(xi) defines investment contracts as securities, the transactions described herein are securities.

Concerns about Pension Advance Schemes

VFG used a network of agents to sell risky products across the United States and had multiple website domains to amass pensioners who were interested in getting paid

a lump sum for their future pension payments.⁷ Staff received information from several investors,⁸ many were older Americans, who used a substantial portion of their savings or retirement to purchase what they thought was a “low risk” product. Many investors were not informed about the redirect risk and were left with a financial shortage when the pension income stream was redirected for whatever reason. Further, many investors purchased more than one pension income stream through VFG.

Whether a scheme is considered an investment contract and therefore a security is determined by case law tests adopted by various courts. Depending on what standard or test a state court adopts, enforcement against a pension advance company may not be an option under the state’s securities laws. Since not every state has an investment contract analysis similar to Arkansas, not every state considers these transactions to fall within the ambit of securities regulation. Additionally, this analysis does not speak to whether these transactions would be considered securities under federal law. Fortunately, Arkansas courts use the risk capital test, and the Department was able to take enforcement action against VFG since the transactions are investment contracts under Arkansas law.

Pension income streams are relatively new on the market and present a unique challenge from a regulatory perspective because of the diverse case law regarding investment contracts. Although VFG’s principal place of business was located in Arkansas, most sellers, buyers, and agents were located in other states. Nation-wide investment schemes like the VFG transactions are becoming more common because of the ease of communication and dissemination of information through the internet. The

⁷ A list of VFG’s website domains under management in April 2011 is attached as Exhibit C.

⁸ Redacted investor letters are attached to this testimony as Exhibits D-H.

Department's orders concerning VFG only apply to any transactions the company conducts from Arkansas and may not extend to other states.

Conclusion

The Department encourages all potential investors, especially older Americans, to investigate before investing. Many investors were approached about this product by someone they already knew and with whom they had a professional relationship. The two Arkansas investors bought this product from agents through whom they had already purchased investments in the past. Both agents were located in Texas. Older Americans, especially those already in retirement, are exposed to great financial risks when investing in products such as these. Educating the investing public about the risky nature of these products is imperative going forward.

Thank you for your attention and for providing me with the opportunity to testify before the Committee today. I would be happy to answer any questions you may have.